IN THE COURT OF APPEAL OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an appeal by way of stated case on a question of law for the opinion of the Court of Appeal under and in terms of Section 11A of the Tax Appeals Commission Act No. 23 of 2011 (as amended)

C.A Case No:
CA/TAX/01/2016

Tax Appeals Commission No:
TAC/1T/048/2013

Carbotels (Private) Limited,
400, Deans Road,
Colombo 10

Appellant

-Vs-

Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A. Gardiner Mawatha,
Colombo 2

Respondent

Before : **D.N. Samarakoon, J.**
B. Sasi Mahendran, J.

Counsel : Dr. Shivaji Felix with Nivantha Satharasinghe for the Appellant
Manohara Jayasinghe SSC for the Respondent

Written Submissions On : 07.04.2022 (by the Appellant)
22.04.2022 (by the Respondent)

Argued On : 19.01.2022

Decided On : 25.05.2022

B. Sasi Mahendran, J.

The Appellant Carbotels (Private) Limited, part of the Hayleys Group, is a holding company carrying out investments in the hotel sector. The Appellant claimed a loss of Rs. 5,018,590/- for the year of assessment 2009/2010 and the return of income submitted by the Appellant was rejected on 28.06.2011. It was rejected because the Assessor has not allowed the expenses arising from the dividend income. The Appellant appealed against this determination of the Assessor to the Commissioner General of Inland Revenue (hereinafter also referred to as the "Respondent") by letter dated 11.11.2011. In the said letter the Appellant company noted that the dividend income does not come under the total statutory income and that the losses can be deducted under Section 25 of the Inland Revenue Act No.10 of 2006, as amended. In his determination dated 30.10.2013, the Commissioner General increased the assessment made by the Assessor. Dissatisfied with the said determination an appeal was made to the Tax Appeals Commission (hereinafter referred to as "TAC"). The TAC, in its determination dated 16.10.2015, confirmed the determination of the Respondent.

The Case Stated consists of seven questions of law, formulated by the TAC, forwarded to this Court by the Appellant for its opinion. These questions of law, reproduced verbatim, are as follows:

1. Is the Commissioner General of Inland Revenue lawfully entitled to widen the scope of an assessment and to thereby increase the amount assessed when making his determination?

2. Is the determination of the appeal made by the Tax Appeals Commission time barred by operation of law?
3. Is the assessment, as confirmed by the Tax Appeals Commission, bad in law since the Assessor who issued the notice of assessment is not the same person who made the assessment and communicated the reasons for making the assessment?
4. Did the Tax Appeals Commission err in law by concluding that the expenses and/or outgoings and/or deductions claimed by the Appellant and disallowed by the Commissioner General of Inland Revenue were not lawfully permissible deductions?
5. Did the Tax Appeals Commission err in law by concluding that the Commissioner General of Inland Revenue had computed the Appellant's statutory income correctly?
6. Is the amount assessed, as confirmed by the Tax Appeals Commission excessive and without lawful justification?
7. In view of the facts and circumstances of the case did the Tax Appeals Commission err in law when it came to the conclusion that it did?

Question 1: Is the Commissioner General of Inland Revenue lawfully entitled to widen the scope of an assessment and to thereby increase the amount assessed when making his determination?

On the face of it, this question involves two considerations: whether the Respondent is allowed to widen the scope of his assessment and whether he is allowed to increase the amount assessed.

The determination of the Respondent includes profits on disposal of shares of two hotels (in respect of which the share transaction levy has not been charged) which the Appellant treated as exempt profit. On appeal to the TAC, the Appellant objected to this inclusion on the basis that the Respondent is time-barred, by virtue of Section 163(5) of the Inland Revenue Act, from assessing this additional source of income. The Appellant argued that what the Respondent did was in fact make a fresh assessment, and thereby exceed his statutory remit, in respect of un-assessed receipts which the initial Assessor had not taken into consideration. Neither the notice of assessment nor the letter of intimation sent by the Assessor refers to the taxability of the profit arising on the disposal of shares.

The Respondent contended that he had a statutory duty cast on him to ensure collection of the true amount of taxes owed by taxpayers and argued that he was merely "increasing"

the assessment as per Section 165(13) of the Inland Revenue Act. The TAC agreed with this contention.

The jurisdiction of the Respondent when an appeal is made to him is clearly demarcated by Section 165(13) of the Inland Revenue Act. This Section reads as,

In determining an appeal under this section, the Commissioner General may confirm, reduce, ***increase*** *or annul the assessment appealed against and shall give notice in writing to the appellant, of his determination on the appeal.* [emphasis added]

In the instant case, the Respondent has widened the scope of his assessment by varying the contours of the Assessor's assessment by assessing previously unassessed receipts. It is not a mere increase in the quantum assessed, such an increase being within his jurisdiction.

Further, by this variation of the contours of the assessment and making what amounts to a fresh assessment, the Respondent is not in compliance with the time limit set out by the legislature in Section 163(5) of the Inland Revenue Act. Section 163(5) requires the filing of return to be done on or before the thirtieth day of November immediately succeeding the end of that year of assessment and **the assessment having to be done before the expiry of two years from the end of that year of assessment**. The Act is explicit in stating that **no assessment of the income tax payable shall be made** after the said period. The fresh assessment of profits on disposal of shares is thereby out of time.

Thus, this Court is of the view that the Respondent is not entitled to widen the scope of his assessment, beyond the initial assessment undertaken by the Assessor. In the instant case, it was not a mere increase as envisaged in Section 165(13) of the Act, the increase was owing to the said fresh assessment. Further, the fresh assessment was not possible because of the statutory time bar found in Section 163(5). This is not to say that it is possible for the Respondent to widen his scope of assessment if it fell within the time period.

On the other hand, if we presume the Assessee had not appealed the decision of the Assessor then the question arises whether the Commissioner General can make a fresh assessment of his own volition? The answer to this must be an emphatic no.

Question 2: Is the determination of the appeal made by the Tax Appeals Commission time-barred by operation of law?

The Appellant argues that the determination of the TAC dated 16.10.2015, is time-barred by operation of law since Section 10 of the Tax Appeals Commission Act No. 23 of 2011, as amended, requires the Commission to hear and determine appeals made to it "within two hundred and seventy days from the date of the commencement of its sittings for the hearing of such appeal". (The first oral hearing in the instant case took place on 19.06.2014). Further, upon a consideration of the several amendments made to the Tax Appeals Commission Act, the time limit granted to the TAC to make a determination is mandatory and requires strict compliance.

The TAC in its determination explained the reasons for the delay in making its determination, which included the untimely demise of the Chairman of the Commission and changes in the membership of the Commission.

Nonetheless, it has been established by a series of decisions of this Court that the time limit spelled out in Section 10 is not a mandatory provision. (See CIC Agri Business (Private) Limited v. The Commissioner General of Inland Revenue, CA Tax 42/2014 decided on 29.05.2020, Kegalle Plantations PLC v. Commissioner General of Inland Revenue, CA Tax 09/2017 decided on 04.09.2018)

Question 3: Is the assessment, as confirmed by the Tax Appeals Commission, bad in law since the Assessor who issued the notice of assessment is not the same person who made the assessment and communicated the reasons for making the assessment?

The Appellant contends that the Assessor who issued the letter of intimation setting out the reasons for assessment (one J.M.S.S. Ratnawardhna, Assessor, Unit 10) is not the same Assessor who sent out the notice of assessment as the notice of assessment bears the frank of one G.A.O. Jayawansa, Senior Assessor, Unit 10. It was argued that by virtue of Section 163(3) of the Inland Revenue Act read together with Section 164 of the same, the Assessor who issues the notice of assessment and the Assessor communicating the reasons for non-acceptance should be one and the same person. The TAC rejected this contention.

It is manifest that a duty is imposed on an Assessor not only to give reasons for non-acceptance of a return but also to communicate them to the Assessee (vide D.M.S. Fernando v. Ismail [1982] 1 SLR 222). The rationale was elucidated in the clearest of terms by His Lordship Samarakoon C.J. in the same case.

"Under the law that existed at the time, the Assessor was not bound to disclose any reasons either on the file or by communication to the Assessee. The Assessee could only appeal against the quantum of assessment and the onus of proof lay on the Assessee. He could only speculate on the reasons for such assessment for the purposes of his appeal. The picture is now different….

The primary purpose of the amending legislation is to ensure that the Assessor will bring his mind to bear on the return and come to a definite determination whether or not to accept it. It was intended to prevent arbitrary and grossly unfair assessments which many Assessors had been making as " a protective measure". An unfortunate practice had developed where some Assessors, due to pressure of work and other reasons, tended to delay looking at a return till the last moment and then without a proper scrutiny of the return, made a grossly exaggerated assessment……. Under the amendment when an Assessor does not accept a return, it must mean that at the relevant point of time **he has brought his mind to bear on the return and has come to a decision on rejecting the return. Consequent to this rejection, the reasons must be communicated to the Assessee.**" [emphasis added]

In the instant case, communication of the reasons of the Assessor has taken place albeit the notice of assessment is not issued by the same Assessor who made the assessment and communicated his reasons for the same. However, when the purpose of this practice is observed, it is clear that in the instant case, the Assessor, one J.M.S.S. Ratnawardhna, has done what was required of him by giving his mind to the return and making a definite determination not to accept it. He has communicated his reasons for arriving at his decision to the Appellant. No prejudice could be said to have been caused to the Appellant.

Therefore, we hold that merely because the Assessor who issued the notice of assessment is not the same Assessor who made the assessment and communicated the reasons for making the assessment, the Assessment is not bad in law.

Question 4: Did the Tax Appeals Commission err in law by concluding that the expenses and/or outgoings and/or deductions claimed by the Appellant and disallowed by the Commissioner General of Inland Revenue were not lawfully permissible deductions?

Question 5: Did the Tax Appeals Commission err in law by concluding that the Commissioner General of Inland Revenue had computed the Appellant's statutory income correctly?

Questions 4 and 5 will be answered together.

In the instant case, the Appellant declared the dividend income under Section 3(e) of the Inland Revenue Act and excluded it from its total statutory income under Section 63(d) of the same after deducting the relevant expenses under Section 25. The Assessor agreed that this income must be categorized under Section 3(e) but did not allow this deduction. At the appeal, the Respondent determined, according to the nature of the business of the Appellant, that dividend income would exclusively come under Section 3(a) of the Act since the said dividend income is received as part of the business income of the Appellant and not as an isolated source of income (passive income) other than its business income and allowed for the necessary deductions of expenses incurred in the production of that income. The reason given was that the Appellant invests its money in shares. The Respondent relied on the case of Ceylon Financial Investments v. Commissioner of Income Tax 43 NLR 1 in order to substantiate his position.

Further, the said dividend income cannot be considered in terms of Section 63(d) and the expenses incurred in production can be deducted as per Sections 25 and 26 of the Act.

This Court has to consider whether the Respondent has correctly identified whether the dividend income in question can be categorized under Section 3(a) and whether the Appellant, in fact, carries out a business.

In the case of Ceylon Financial Investments (supra), decided in 1941, His Lordship Howard C.J. referred to the following judgments to determine that the company whose income was derived from dividends declared by companies in which it owned shares, was in fact a "business".

In Commissioners of Inland Revenue v. the Korean Syndicate 12 T.C. 181, Atkin L.J. held,

"For I see nothing to prevent a holding Company, which a very well-known method of doing business in these days, from carrying on a business."

His Lordship also referred to the following passage from Lord Sterndale M.R.'s judgment as well.

"An individual comes into existence for many purposes, or perhaps sometimes for none, whereas a limited Company comes into existence for some particular purpose of carrying out a transaction by getting possession of concessions and turning them to account, then that is a matter to be considered when you come to decide whether doing that is carrying on a business or not."

In Commissioners of Inland Revenue v. The Westleigh Estates Co. Ltd., The South Behar Railway Co. Ltd., The Eccentric Club Ltd., 12 T.C.657, Lord Sumner held,

"It is obvious that the Company's objects have by no means been accomplished. It is obvious, too, that during its present period of dormant life it has very little to do. I do not attach much importance to the domestic operations of declaring and paying dividends, remunerating directors and presenting reports, but the operation of receiving and thus discharging the annuity payments goes on continuously, and however simple, it is not a mere passive acquiescence. It is the transaction of business between debtor and creditor resulting periodically in the discharge of a debt. The present is not the case of a company existing to do one act only and once and for all. Not only did the company make the agreement of 1906, but it plays its recurring part in every payment and receipt of gains, and there is here, therefore, that 'repetition of acts', which Lord Justice Brett says is implied in 'carrying on business' ".

Having referred to these judgments, His Lordship Howard C.J. held,

"Applying the principles laid down in the English cases which I have cited there can be no doubt that the appellant company, though functioning as an Investment Company only for which purpose it came into existence, has not accomplished its purpose and was carrying on business. I am, therefore, of the opinion that the income derived by the appellant company from dividends and interest fall within the words "profits from any business" under Section 6 (1) (a)[of the old Act]"

His Lordship Keuneman J. arrived at the same conclusion when His Lordship held,

"But it is manifest that its objects have not been accomplished and although at present it carries on a "passive" or "dormant" life, it has not ceased to carry on business. The operation

of receiving and discharging the debts due to it is regularly repeated. In fact, it carries on business in the way that a holding company carries on business".

It is therefore clear that the business carried on by the Appellant company, can in fact be deemed to be a "business", and the dividend income can be categorized under Section 3(a). The Appellant too, in its written and oral submissions, agrees that since it is essentially a holding company which invests in subsidiaries and associate companies, dividends received by it come within the scope of Section 3(a).

In fact, Justice Akbar in The Commissioner of Income Tax v. Arunachalam Chettiar 37 NLR 145, was of the view that discretion is vested in the Crown to elect whether it will charge under paragraph (a) or (e).

If, it is so categorized, the particular income forms part of the statutory income. Then it is not a passive income. It loses the character of passive income and under Sections 25 and 26 that income can be taxable.

His Lordship Keuneman J. in his judgment made the following observation in this regard,

"If then the business of an individual or a company consists in the receipt of dividends, interest or discounts alone, or if the business of receiving dividends, interest or discounts can be clearly separated from the rest of the trade or business, then any special provisions applicable to dividends, interest or discount must be applied."

The above interpretation has now been given a statutory footing, by virtue of the amendments introduced in 2014 and 2015, to Section 63, which at the argument stage, this Court brought to the attention of the learned Counsel. This Section reproduced for the purpose of convenience, reads as follows,

Where a dividend is paid by any resident company to any resident or non-resident company, and either—

(a) a deduction has been made under section 65 in respect of that dividend by the first mentioned resident company;

(b) that dividend is exempt from income tax under section 10;

(c) such dividend consists of any part of the amount of a dividend received by the first-mentioned resident company from another resident company; or

(d) such dividend is a dividend declared by a quoted public company, profits and income from such dividend shall, notwithstanding anything to the contrary in any other provision of this Act, be deemed not to form part of the total statutory income of the second mentioned company.

For the purpose of this section the profits and income from such dividends which form part of the profits under section 3(a) of this Act, means profits and income after deducting expenses in ascertaining the profits from such business of receiving dividends.

Therefore, we hold that both the Respondent and the TAC correctly identified that the dividend constituted part of the statutory income and allowed the deduction of expenses.

It is true that originally the Legislature was of the view that Section 63 exemption applied only to dividend income within Section 3(e) But there was an amendment to the effect that if dividend income falls under Section 3(a) then expenses are deductible when determining assessable income.

When considering the material before it, this Court observes that throughout the Appellant wanted to claim the benefit of Section 63(d), by categorizing it under Section 3(e), but to have the expenses incurred in the production of that dividend income to be deducted from their income, which derived from the dividend income. The conduct of the Appellant is an example of the proverb that 'you cannot have the cake and eat it too'.

Question 6: Is the amount assessed, as confirmed by the Tax Appeals Commission excessive and without lawful justification?

Question 7: In view of the facts and circumstances of the case did the Tax Appeals Commission err in law when it came to the conclusion that it did?

In view of the opinion of this Court set out above, we hold that questions 6 and 7 must be answered in favour of the Appellant. The Respondent's assessment is excessive and without lawful justification, and therefore the TAC erred in law when it reached the same conclusion.

Therefore, having answered questions 1, 6, and 7 in favour of the Appellant, we remit the case record to the TAC under Section 11(A)(6) of the TAC Act to revise the assessment according to the opinion of this Court.

JUDGE OF THE COURT OF APPEAL

D.N. SAMARAKOON, J.

I AGREE

JUDGE OF THE COURT OF APPEAL